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THEBE SECURITIES

Gold - The big flight to safety

With so much uncertainty in the global markets, gold seems to be the most fashionable investment right now as investors seek a safe haven asset to hedge against the uncertainty brought about by the current global economic turmoil. It is once again being recognized as the ultimate store of value. The historically strong negative correlation between the spot gold price with the US Dollar seems to have broken down in recent months.

Strong gains in the US Dollar in recent months from record lows against the Euro have not seen the gold price fall. Investors have ignored this relationship and pushed the gold price to 11 month highs above US$1000 an ounce at one stage. This is a strong indicator of how strong the appetite for gold really is at present. While the strengthening of the US Dollar has limited the US Dollar gains in the gold price, when priced in Euros, Sterling, Canadian dollars and the Rand, gold actually made all time record highs in February.

At present, the momentum of the gold price seems to remain strong and there are many factors that are likely to maintain this positive momentum. Central banks are selling less gold, global production continues to fall and there is strong investment buying. Buying of gold by gold backed exchange traded funds (ETFs) such as SPDR Gold Trust, which is the world's biggest gold ETF, has reached record levels in recent weeks. ETF investment jumped to 244.7 tons in the last 6 months of 2008 from only 76.7 tons in the first half. SPDR's holdings have already increased by 228 tons to 1008.8 tones since the beginning of 2009. In the same period last year, its gold holdings rose just over 3 tons.

Statistics from the World Gold Council estimated that in 2008, around 58% of global gold demand came from the jewellery industry, 11.8% from industrial and dental uses and the remaining 30% of demand was for investment purposes (ETFs, retail investments - coins, medals, bars). With the record gold prices seen last year, the gold demand for jewellery purposes fell by 11% and demand for industrial purposes fell by 7%. However, investment demand increased sharply by 64% in 2008, making up for weaker demand in other areas and increasing demand in 2008 by 4%. This illustrates why the spot gold price performs unlike any other commodity price. Falling energy and other costs, combined with the higher gold price will have a strong positive impact on gold miner profit margins, thus also illustrating the negative correlation gold stocks have with several other commodity stocks.

On the supply side, mining production has decreased steadily over the past few years. According to the World Gold Council, annualized global gold production for 2008 was around 2400 tons, down from 2476 in 2007. After taking into account hedging activities and supplies of old gold scrap, the total global supply of gold has decreased over the past few years. There has been an increasing deficit of gold supply relative to higher demand. Gold demand exceeded supply by 22 tons in 2007 and this increased sharply to a 162 ton deficit in 2008.

Gold miners have not increased their production in reaction to higher prices and they are not likely to do so until prices see some stability at their current high levels. Global production of gold by gold miners recorded its largest annual decline in 2008 despite the near record prices. Global gold production output actually peaked in 2001 and has been in decline every consecutive year since then. In South African in particular, the trend is more striking. In 2008, local output fell to its lowest level in 86 years, reducing South Africa to being the world's third largest producer behind China and the United States.

As has been stated many times before, our recommendation for investors wanting to get exposure to gold is to do it by investing in the **New Gold ETF**. This instrument gives investors more efficient exposure to the movement in the spot gold price and removes all the inefficiencies (labour issues, declining output and reserves, escalating costs) that limit the price gains of the local listed gold miners. Nevertheless, of the available listed Gold miners, Goldfields remains the relatively favoured company out of the three largest South African listed gold producers.

A comparison of the gold miners and their relative performances over the past few quarters is shown in the table at the bottom of the page:

In the table, each company's latest quarterly result(Qtr-Dec08) is compared to the result reported in the prior quarter (Qtr-Sept08) and the corresponding quarter exactly 1 year ago (Qtr-Dec07).

Relative to their respective quarters a year ago (December 08 relative to December 2007), all of the companies showed strong cash cost increases. Revenues also increased but not to the same extent as cash costs. Production over this time period actually fell for all the gold producers during the year.

Nevertheless, the performance of each of the gold producers showed an improvement on the quarterly period to December 2008 relative to the prior quarter to September 2008. Gold revenue in rand increased much faster than the cash costs and production increased for AngloGold Ashanti and Goldfields.

AngloGold Ashanti - The group recently reported its 2008 final results. Gold production for the quarter as shown below was better than the previous quarter and better than market expectations. This was attributed to the results of the group's turnaround strategy. The unattractiveness with the group at present continues to be its hedge book, which being the biggest among its peers globally, reduces its exposure to the record spot gold price. The gold price the group received was 13.6% below the average spot price for the latest quarter. Nevertheless, the group has been reducing its hedge and the price received was an improvement on the 26% discount to average spot price achieved in the 3rd quarter.

In 2008, hedge commitments were reduced by 47% from 11.29Moz at the end of 2007 to 5.99Moz. For 2009, the price received is expected to only be 6% lower than the spot. For 2009, the company is expecting to produce between 4.9Moz and 5.0Moz of gold (2008 4.98Moz) at total cash costs ranging from $435/oz to $450/oz (2008 US$444) at current exchange rates. Considering the reduced hedge

Company	Gold Revenue - Rand/kg			Gold Produced - Kg			Total cash costs - Rand/kg			12 month	Current	Forecast	Fwd	Current
	Qtr-Dec08	Qtr-Sept08	Qtr-Dec07	Qtr-Dec08	Qtr-Sept08	Qtr-Dec07	Qtr-Dec08	Qtr-Sept08	Qtr-Dec07	rolling Heps	PE	FY09 Heps	PE	Price -c
AngloGold	219329	160127	149312	39429	39336	42556	134813	121440	87744	-1379	-	2148.3	15.3	29755
Goldfields	250058	217586	170488	26093	24817	29861	153893	153461	101532	406	28.59	541.4	21.4	10706
Harmony	253441	217295	169502	11267	12287	12403	168299	157279	133234	192	67.03	415	31	12451

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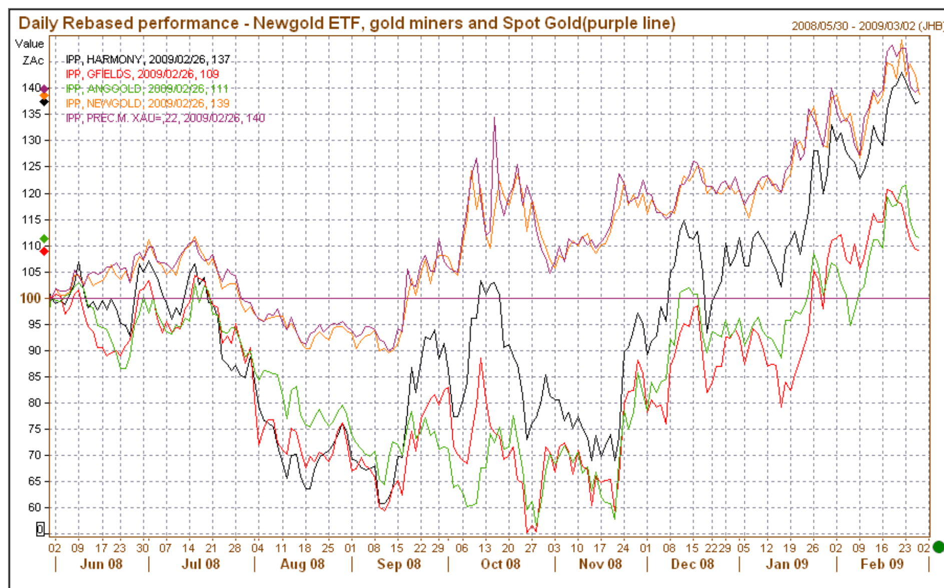

book and if the group is able to achieve the production and cash cost targets for the year ahead, the 2009 financial results should show a significant improvement as shown by forecasts in the table.

Goldfields - The 2009 2nd quarter showed that it was putting most of the problems (massive cost increases, its shaft rehabilitation at Kloof and the Eskom crisis) it experienced for most of the 2008 calendar year behind it. Cash costs in Rands were flat, but in US$, fell by 21% due to the effects of the weaker rand. Production volumes improved from the first quarter, thus reducing unit costs. HEPS were up significantly from 6c (affected by high capex and low volumes) in the prior quarter to 74c in the latest quarter. Although the share trades at a forward PE premium to AngloGold Ashanti, it is preferred because being an un-hedged producer will give investors greater exposure to the spot gold price. The large reserves of the South Deep assets also warrant the premium. Goldfields is our preferred listed stock of the three largest South African producers.

Harmony - Harmony continues to remain a higher cash cost producer than its two larger peers and its growth prospects are not as exciting. The relatively higher historical and forward PE multiple it trades at thus seems somewhat unjustified. Its share price has performed better than its peers over the past few months, but one has to consider that it is coming off a relatively lower base. The turnaround in performance for the group in recent quarters is admirable but at present it is not our preferred choice.

Despite the very bullish short to medium prospects for gold, there are several roadblocks that could hamper the strong upward momentum. It has been forecast that the continued high gold price will continue to put downward pressure on its demand from the jewellery sector, with 2009 jewellery demand estimated to fall by around 11% from 2008 levels. Also, with the gold price running so hard and the strong involvement of speculators, profit taking could force ETFs to become forced sellers, with very few buyers to sell too. The risk of bullion sales by banks and strengthening of the rand are always negative considerations one should think of when investing in gold.

For investors wanting exposure to gold, the NewGold ETF is the preferred vehicle of choice(because of its efficiency as shown in the chart above), followed by Goldfields, which is the preferred listed gold producer out of the three largest South African listed Gold stocks. The important consideration for gold investors this year will be whether the fall in demand for gold for jewelry and commercial purposes (due to record gold prices) will continue to be adequately compensated by the increased demand for investment purposes due to the metals safe haven personality. At this point in time, it looks like investment demand will continue to make gold the investment of the moment, but the important question for longer term sustainability is, for how long can this investment demand offset the weaker demand from the jewelry sector. Thus, this year, gold is the ideal investment for anyone that remains pessimistic on the short term recovery prospects for the global economy.

February market summary

February was an eventful month in many respects and below is a summary of some of the major developments:

- The South African corporate earnings season got into full swing in February, with many companies still reporting decent growth for the 2008 year. Nevertheless, the market seems to have placed more emphasis on the forward outlook for companies rather than the 2008 earnings in light of the meltdown that got worse during the 2008 4th quarter.

- Attention is still on developments in the US. Signs of continued weakness in the US economy continued to appear and this drove US stocks lower. The Dow Jones Industrial Average and the S&P500 fell to 12 year lows, breaking through technical support levels. Job losses showed their worst monthly change in 34 years, but in a positive sign, the markets paid little attention to this. Some positive economic news in the US and UK came from their services sectors, where data came in better then expected. Nevertheless the ultimate driving factor that pushed US stocks lower was concern from the market that there is not enough detail available on the Obama administration's proposed economic bailout plans.

- New motor vehicle sales were 35.4% lower in January from a year ago. The local car sector, reflecting the general global trend and estimating that around 22500 jobs are on the line, is also looking to the South African government for a rescue package in the region of around R10bn.

- The SARB cut rates by 100 basis points in February and gave strong indications that further cuts before its next meeting in April are a strong possibility. The recent release of weak GDP data and the sharp decline in inflation have significantly increased the likelihood of another cut sooner rather than later.

- Gold rallied sharply this month on back of weak economic data for major currencies. Spot platinum prices also followed gold's trend despite bearish sentiment from platinum producers on the outlook for platinum in 2009.

- The 2009/10 national budget was also announced, as well as 4th quarter 2008 GDP figures, which saw the South African economy contract in the last quarter of 2008, the first quarterly negative growth rate in 10 years.

- Indebted global miner Rio Tinto agreed to sell $12.3 billion of its best assets to China's largest aluminium producer, Chinalco, and sell $7.2 billion in convertible notes to that state owned group. This reflected the downside to being highly geared when the market makes a turn for the worst and it also reflects that at present, mines in particular are strapped for cash and they are having problems worldwide getting financing.

- The negative effect of the global financial crisis on BEE deals was highlighted by **MTNs** announcement that it would not go ahead with plans to sell 5 - 6% of its shares to black investors due to "severe constraints in the current financial markets". The announcement that Mvela Resources may be de-listed also shows the impact that falling commodity prices stemming from the global financial crisis have had on BEE deals. Falling commodity prices have left Mvela Resources with little option but to consider delisting as its ownership structure, where more than 50% of its income comes from another listed company (Northam platinum) is not permitted by the JSE. Impala Platinum also recently walked away from plans to acquire Mvela Resources and Northam.

Sasol

In January, the group released a trading update and said that it expected its 2009 interim HEPS to increase by between 55% to 65%, from the comparable 2008 interim HEPS. This growth is mainly a function of the higher average oil prices seen in the 2009 interim period, helped mainly by record oil prices in the 3rd quarter of 2008 and the weaker average Rand/$ exchange rate throughout the interim. Additional capacity in the interim and improved operating performances are also said to have contributed to a strong performance. The interim forecast will give the group a 12-month rolling HEPS of between 4611c and 4684c when it releases its results on the 9th of March. Based on a price of 24900c at the time of writing, Sasol will trade at a rolling historical PE of between 5.32 and 5.4.

The plummet in oil prices since the 4th quarter of 2008 resulted in Sasol revising its 2009 earnings outlook downwards. It has stated that it expects a moderate reduction in full year 2009 earnings relative to 2008. In this market it would be prudent to trust the most pessimistic outlook. The worst case scenario, based on the lowest EPS estimate of 3650c (a 6.5% decline on the 2008 EPS of 3902c) for the June 2009 year-end, gives Sasol a resultant forward PE of only 6.8.

Aside from the much lower average oil price, profitability in Sasol's chemical segment remains a negative consideration and will have an unfavourable effect on the overall margins. Petrochemical prices and sales volumes are expected to remain weak in the near future and only start to assist earnings in the next 2010 financial year. It is also uncertain how the 318m Euro fine given by the EU for anti competitive practices will be accounted for by the group. It could be accounted for as a contingent liability, while it appeals against the fine. The current results will also reflect the short-term benefit the group will get from hedging 30% of its Synfuel production at an oil price of US$90 and this benefit will not be seen after 2009.

Nonetheless, in such an uncertain investment environment, companies that have the ability to still generate strong cash flows and can continue paying dividends are highly sought after. In its trading update the group said that it continues to generate considerable cash flows that put it in a strong position to weather the current economic climate and easily service all existing debt requirements.

Like most companies, Sasol has gone into a cash preservation mode and is reconsidering its position on share buybacks. Sasol nevertheless offers good value for shareholders at present levels. This is made with the assumption that oil prices are close to a sustainable support level and there will not be a significant deterioration to below US$35 per barrel. Opec has also aggressively been cutting production to support oil prices. Sasol is a buy at its current price if it can maintain its dividend through these tough times.

PSV Holdings

PSV Holdings is a general industrial engineering company listed on the AltX. It provides flow control products, services and electromechanical solutions to the mining, petrochemical, power generation and water and waste management sectors in South Africa and in Zambia. In its last set of interim results to the period ending August 2008, revenue grew 45.7% to R174.7m, EBITDA increased 35% to R20.9m, while HEPS increased 21% to 5.14c. Despite several acquisitions over the past few years, the bulk of its recent growth has been organic.

The segmental report divides PSV into three different divisions:

1: Pumps, spares and valves division

This division has several different subsidiaries, the largest being *PSV Services*, which supplies pumps, pump spares and valves to water and slurry operations at mines. Several large mining operations, as well as water utilities are serviced by this division, which in its 2009 interim contributed the most to the overall operating profits.

There are several other smaller subsidiaries in this segment, involved in supplying pumps, spares, maintenance and repairs *(Dasher)*, pump repair and refurbishment in Zambia (*PSV Zambia*), pump equipment manufacturing (*APE Pumps*), and importing and distributing speciality pumps and valves to various industries (*Umzantsi*).

The Pump and Valves segment contributed 26% to group revenue in its last interim period but relatively higher margins resulted in it contributing 45.2% to profit before tax. The margins in this division were nevertheless weaker than the 2008 interim as the recently acquired Dasher and APE pumps businesses contributed to profits. With 25000 pumps from APE in circulation, there are strong annuity flows that will continue to come from servicing and maintenance activities. The group has also recently announced the acquisition of *Mather and Platt*, a supplier of pumps and spares.

Apart from the mining industry, some of the best growth prospects for this segment will come from increased government infrastructure expenditure plans for water supply maintenance, as well as planned government expenditure on nuclear infrastructure.

2: Engineering linings and industrial supplies

This segment has 3 subsidiaries: *Omnirapid* supplies mining and industrial consumables to local and African industrial and mining companies. *Group Line projects* is involved in the fitment of ceramics and glass-based lining products that change the flow characteristics of coal and similar materials. A major customer is Eskom. Recommissioning of Eskom coal plants and maintenance of the plants is expected to be a strong growth driver in this division. *Engineering Linings* exports around 70% of its products, and is involved in the supply and installation of geo-synthetic liners for containment and environmental and corrosion protection. Some applications for these liners include waterproofing, storage dams and lining of land fills.

3: Specialised services

This segment has 2 businesses: *Petrologic*, which is involved in manufacturing, supply, installation and maintenance of fuel handling systems at service station forecourts and fuel depots. The bulk of its income comes from service contracts with large petrochemical companies such as Engen. The margins are relatively small in this business and thus despite a large revenue flow (35% of group revenue), the bottom line contribution is less (15% of operating profits).

Rand Air and Gas installation, a recently acquired business, should help raise margins in this business segment. It is a manufacturer of liquefied gas storage equipment and only has one competitor in South Africa.

The group will be releasing its next full set of results for its February year-end in May and indications from management are that it has had a good 2009 year and its growth prospects remain strong for the foreseeable future. The group is on a very low rolling PE of 2.66 based on a price of 31c and rolling HEPS of 11.62c. A forecast of 84% growth in the 2009 fully diluted Headline Earnings per share to 14.6c gives the group a forward PE of only 2.1.

On a price of 31c, PSV trades far below its net asset value of 96.6cps. This is the case with many AltX listed companies which have been sold off indiscriminately. PSV was started 20 years ago, so it is a well-established and diversified business with strong synergies amongst its various businesses. The group has strong annuity income especially from its maintenance contracts across various business segments. Management recently mentioned that, particularly in the mining industry, a major strength lies in the fact that mining companies must continually spend money on pump maintenance. This is a favoured pick for a recovery amongst small cap shares and can be considered as a buy.

Anglo American and BHP Billiton

In the latter half of February, **Anglo American** released its 2008 full year results that disappointed the market, as investors did not expect it to miss earnings forecasts to that extent.

Most analysts had forecast underlying earnings per share of US493c for the 2008 final results. They were very disappointing at US436c, 11.6% below the consensus and 1% lower than the 2007 EPS figure. The operating profit was US$9.8bn, also missing the forecast of US$10.1bn. Higher than expected cash costs and lower realized prices particularly in the coal and base metal divisions and lower realized sales volumes for most divisions were the major reasons for the group results falling below the market's expectations.

A major shock for the market was that no dividend was declared. This was the first time since World War Two that Anglo American did not pay a final dividend. A dividend of US130c had been forecast for 2008. The dividend suspension leaves the group with a full year dividend of only US44c. Considering the fact that AngloPlats did not declare a dividend, the market should have perhaps been less surprised. On the day that Anglo American released its results, its share price plummeted 16% and it is now only the third largest company on the JSE, ranked by market capitalization, after BHP Billiton and SAB Miller.

Since the release of the results, according to Reuters consensus estimates data, there have already been several large analyst downgrades for the 2009 financial year. Currently, the 2009 underlying consensus EPS have been forecast at around US123c (updated after the latest result release). This would give Anglo American a forward PE of 12.03 based on a price of R148 and Rand/US$ exchange rate of 10. With Anglo American unsure itself about future dividend payments, if would be prudent to assume that a dividend might not be paid at the end of this year.

In addition, the group also declared that it would cut 19000 jobs (this includes the 10000 announced by Amplats), and a cost saving target in the region of US$2bn as a result of this is expected. The group is also going to have to inject $225 million, interest free for two years, into its 45% owned De Beers division, as part of the $500 million in loans from the company's three shareholders. The global economic crisis has hit the retail diamond industry particularly hard. A further ominous sign for prospects is that its net debt in 2008 increased sharply by US$5bn to US$11bn. This was expected by the market, but nevertheless is a major concern, as gearing rose to 37.8% from 20% at the end of 2007.

Accompanying the reasons for the dividend cut, Anglo's CEO, Cynthia Carroll said "given the horrendous market conditions which are likely to materially impact our 2009 earnings, any other decision would have been wrong. It would have put our balance sheet under undue pressure." In addition to the dividend cut, the group had mentioned last year that it was cutting capital expenditure in 2009 by half to US$4.5bn and postponed several mining projects to conserve cash.

The sale of additional stakes in AngloGold Ashanti and plans to suspend share buybacks should also help reduce debt levels. This was a wise move considering current undesirable situations of more highly geared peers, Xstrata and Rio Tinto, which are involved in asset sales and right issues in the depressed market conditions. Anglo American has mentioned that neither asset sales nor a rights issue would need to take place this year.

BHP Billiton also recently reported its 2009 interim results. The 2008 July to December period saw its revenue up 16.6% to round US$30bn and its underlying EBIT up 23.7% to $11.9bn. The bottom line was negatively affected by exceptional items such as the US$386 due diligence costs for the now defunct Rio bid and the suspension of the Ravensthorpe Nickel project. Given the unprecedented fall in the price of commodity shares, BHP Billiton can consider itself very fortunate that nothing came of its bid for Rio when it was first made. BHP Billiton's normalised HEPS fell by 1.4% to 103.5c. Exposure to coal and iron ore, like Anglo American, was a strong earnings contributor and new oil and gas production was also a strong profit contributor (Anglo does not have exposure to this).

The positive distinguishing factor from its peer is that BHP Billiton had stronger cash flows and reported a 73.9% increase in net operating cash flow to $13.1bn. This easily covered its US$6bn exploration and capital expenditure costs and a dividend of $2.3bn (41cps, which is actually equal to the final 2008 dividend).

Even considering the expected large drop in earnings in the year ahead, Anglo American does appear to be offering good value and can be considered at its current levels for investors that are willing to take on the risk that the worst of the global economic news is already out in the open. It might initially appear to offer better value on a historical PE basis than rival BHP Billiton but there is a good reason why investors pay a premium in bad times for companies that are cash flush and are relatively debt free.

Anglo American has a historical PE ratio of 3.39, a 2009 forward PE of 12.13 and a gearing ratio (net debt to total capital) of 37.8%, with 2009 gearing expected to be around the same level. By comparison BHP Billiton with a price of R158 has a rolling PE ratio of 5.77, a 2009 forward PE of 8.67 and a gearing ratio of only 10%, with 2009 gearing expected to increase slightly. Anglo's higher leverage and having fallen much more then its peers, could lead to a quicker recovery then the other diversified commodity counters, which could occur even before the global economy shows signs of recovery.

However, in comparison with BHP Billiton's results, it is important to ask whether Anglo American's results are simply a sign of the times or were some bad decisions made by the group's current management team particularly in the latter half of 2008? At the top of the commodity cycle, the group bought its Brazilian MMX iron ore assets. What further annoyed investors was that Anglos up to a few months ago had bought back millions of its own shares. That is like buying shares with borrowed money. It sold large stakes in what could most likely have been one of its best performing assets this year, AngloGold Ashanti and it also rapidly increased its debt at a very inopportune time.

Even ignoring what might appear to be bad decisions by the group, BHP Billiton does appear to be a better alternative with its lower gearing, stronger cash flows and high returns on capital. It looks cheaper on a forward basis and has no exposure to precious metals, platinum group metals in particular, where despite the recent bounce in spot prices, the outlook still remains heavily dependent on recovery of global auto demand. The short-term environment for diversified miners, as admitted by most companies remains very uncertain and volatile but in the longer term, the fundamentals still seem to remain sound and our preference in this sector, BHP Billiton is attractive at its current price.

Daily Rebased performances since the beginning of 2003 bull run

2003/01/01 - 2009/03/27 (JHB)

IPP, ALL SHARE INDEX, Last Trade(Last), Specified Date, 2003/01/01, 100.0
2009/02/26, 205.75
IPP, BHPBILL, Last Trade(Last), Specified Date, 2003/01/01, 100.0
2009/02/26, 364.04
IPP, ANGLO, Last Trade(Last), Specified Date, 2003/01/01, 100.0
2009/02/26, 111.07

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